Inclusion in Asset Building: Research and Policy Symposium

Reaching Out to the Unbanked

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2000

Working Paper 00-15

Center for Social Development

Washington
WASHINGTON · UNIVERSITY · IN · ST · LOUIS
George Warren Brown School of Social Work

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September 2000

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This paper was commissioned for the *Inclusion in Asset Building: Research and Policy Symposium*, Center for Social Development, Washington University in St. Louis, September 21-23, 2000.

The symposium was sponsored by the Ford Foundation and the George Warren Brown School of Social Work at Washington University. The organizers and editors were Michael Sherraden and Lisa Morris.

I. Introduction

About ten million low- and moderate-income American households do not have deposit accounts of any type. These households are commonly referred to as the "unbanked."

For many of these households, the lack of a bank account presents few problems. They have no financial savings so they do not a need a means to safeguard their funds. They encounter little trouble or expense in cashing checks and making payments and they have no immediate need for credit. But for many other unbanked households, the lack of a bank account does present problems. They may spend a significant share of their limited incomes on basic payment services, cashing checks and making long-distance payments. They find life without financial savings to be stressful. They are acutely aware that any interruption in their incomes or unexpected expense could bring hardship or at least cause them to scramble to meet essential expenses, such as housing and transportation costs. Frequently, they have no access to credit from mainstream financial institutions because past personal financial crises led them to miss scheduled debt service, rental, or utility bill payments. Resulting impaired credit histories leave them dependent in an emergency on high-cost lenders, such as pawnbrokers, payday lenders, car title lenders, and small-loan finance companies.

This paper presents a strategy for helping the unbanked to build savings and to improve their credit-risk profiles in order to lower their cost of payment services, eliminate a common source of stress, and gain access to lower-cost mainstream credit. The strategy has five elements. First, participating banks should open special branch offices, called "outlets," that are conveniently located for lower-income households and that provide fee-based check-cashing services in addition to traditional consumer banking services. Second, these outlets should offer "starter" bank accounts that have low minimum-balance requirements, cannot be overdrawn, and include access to low-cost money orders for making long-distance payments.[1] Third, the outlets should offer accounts, similar to traditional "Christmas Club" accounts, designed to help people accumulate savings. Fourth, the outlets should offer deposit-secured loans to individuals whose credit histories would make them ineligible for mainstream credit. Finally, banks should seek appropriate community-based organizations to help promote the outlets and to offer budget-management and credit-repair seminars to interested patrons of the outlets.

This paper argues that such an approach is likely to be the most effective in assisting the unbanked and, furthermore, that it is realistic to expect many banks to implement it. The proposed initiative will appeal to them because it can be effective while offering them a reasonable rate of return on their investment. In addition, banks that implement the strategy can receive credit toward the "service" component of their Community Reinvestment Act obligations.

The next section of this paper describes the unbanked, noting their demographic characteristics, why they decide to remain outside of the banking system, and the problems that they face as a result of their status. The third section proposes a strategy for bringing the unbanked into the financial mainstream. In doing so, it contrasts the strategy with other initiatives with similar

[1] Throughout this paper I use the term "bank" in its generic sense, meaning that it includes commercial banks, saving banks, savings and loans, and credit unions.

goals. It also provides a description of the operations and experiences of one bank, Union Bank of California, that has already implemented most of the key elements of the proposed strategy.

II. A brief description of the unbanked

Several surveys have attempted to identify the socioeconomic characteristics of households without bank accounts and to ask individuals in these households why they do not have bank accounts. Although the details of these surveys differ, they all find that the unbanked are disproportionately represented among lower-income households, among households headed by African-Americans and Hispanics, among households headed by young adults, and among households who rent their homes. Table 1, based on data from the 1998 Survey of Consumer Finances, presents data supporting such generalizations.

The second issue that the surveys attempt to answer is why people do not have deposit accounts. Again, the details differ across the surveys, but there is a broad consensus in their findings. Families most frequently report that they do not have deposit accounts because they have almost no month-to-month financial savings to keep in the accounts. In 1996, a consulting firm working for the U.S. Treasury Department surveyed a large sample of recipients of federal benefit checks who did not have deposit accounts to inquire why they did not (Booz-Allen, 1997). About half cited "don't have enough money" as the primary reason. In the same year, I commissioned a survey of 900 lower-income households to obtain information on their use of financial services. Of those without accounts, as shown in Table 2, 53 percent cited "don't need account because we have no savings" as a reason; making this the most frequent reason cited.[2] Unfortunately, the Survey of Consumer Finances does not ask people why they do not have a deposit account. Rather, it asks households without checking accounts to give the primary reason that they do not have a checking account. As shown in Table 3, the most common (28 percent) reason cited is: "do not write enough checks to make it worthwhile." "Do not have enough money" is the third most common (13 percent) response.

In the surveys, other common responses for why people do not have deposit accounts include: "bank fees are too high;" "bank minimum balance requirements are too high;" "we want to keep our financial records private;" and "we are not comfortable dealing with a bank." The first two of these reasons are closely related to people's low level of financial savings since depositors able to maintain a month-to-month balance of about $500 or more rarely pay account maintenance fees and rarely write checks that "bounce," leading to non-sufficient funds fees. The desire to keep financial records private could arise because:

- a creditor might seize the savings of a delinquent debtor;
- a former spouse might pursue the savings of an individual behind on his child-support payments;
- welfare eligibility could be threatened by a substantial account balance or by a history of deposits from under-the-table earnings; or
- illegal immigrants might fear that a bank record would reveal their presence to the Immigration and Naturalization Service.

[2] In the survey, respondents were allowed to give more than one reason.

The formal surveys have not delved into these reasons but one ethnographic study finds evidence of these concerns even, in some cases, when there is little legitimate basis for the concerns (Caskey, 1997b). Less common reasons given for not having a deposit account include: "banks won't let us open an account" (presumably because the person has a history of writing bad checks or a severely impaired credit record) and "no bank has convenient hours or location."

As noted earlier, many of the unbanked encounter few problems from their status (Prescott and Tatat, 2000). They have no financial savings so there is no hardship from not having access to a financial institution to safeguard such savings. They cash paychecks for free at an accommodating deposit institution, grocery store, or other business. They purchase money orders from the post office or convenience stores to pay bills by mail. They have no immediate need for credit or do not find that their unbanked status excludes them from the credit that they do need.

Such a sanguine outlook is not, however, true for a significant fraction of the unbanked. In large urban areas, surveys indicate that somewhere between 20 and 40 percent of the unbanked pay fees to cash their paychecks, and many of these patronize commercial check-cashing outlets (CCOs). CCOs cash people's paychecks or government checks for a fee that is usually expressed as a percentage of the face value of the check. Except in a small number of states that impose fee ceilings below two percent, typical fees for cashing low-risk checks range from two to four percent. Some CCOs will cash personal checks, usually for a higher fee to reflect the higher risk that such checks will bounce. CCOs also sell money orders, handle utility bill payments, serve as agents for firms that transfer money electronically, and sell related convenience items, such as photocopying services and prepaid calling cards. Many CCOs have also entered into partnerships with commercial banks so that CCO customers can open a simple non-checkable transaction account at the banks and access the funds through the CCOs or ATMs. In this way, CCO customers can receive electronic deposits of paychecks and yet continue to use the CCO to convert the payment into cash and meet other payment needs.[3]

The problem created by the regular use of a CCO is that CCOs are an expensive source for payment services. Over the course of a year, a family making $18,000 a year can easily spend $500 or more of this limited income obtaining basic payment services at a CCO. Nevertheless, there is little mystery why many individuals without financial savings go to a CCO. The CCO will cash their paychecks instantly. While still standing at the service window, the customers can use some of the cash to purchase money orders with which to pay bills. The CCO also sells stamps and envelopes in which to mail the payments. CCO customers will frequently use some of their cash to pay utility bills, cable television bills, and phone bills at the CCO. In communities with large numbers of recent immigrants, many CCO customers wire some of their funds to family members in the home countries. After conducting these transactions, the customers walk out of the CCO with their remaining cash. They spend this down until the next pay period when they will repeat this procedure.

[3] I am aware of no data on the use of such accounts, but several CCO managers have told me that they have not been popular. The fees associated with these accounts are generally rather high, so it is likely that few customers see any advantage to them.

Given this behavioral pattern, it is understandable why such customers do not go to a bank. Most banks in urban areas won't cash paychecks for people who do not have an account at the bank or who do not have an account with sufficient funds in the account to cover the check. Banks typically require account holders without sufficient funds to deposit the check and wait a few days for it to clear before they gain access to the funds. Although the CCO charges a fee for cashing the paycheck, charges a fee for a money order (generally about $0.35 to $1), and charges a fee for transmitting a utility bill payment (commonly about $1), for someone with no month-to-month savings this can be less costly than relying on a bank. It is very easy for a person who runs his account balance down to near zero at the end of each pay period to "bounce" checks on the account. Each bounced check can cost the account holder $25 to $35.[4] It is also expensive and inconvenient for customers without checking accounts to make long-distance payments. Almost all banks charge at least $1 for money orders, and many charge as much as $3. Moreover, they do not sell stamps and envelopes in which to mail the money orders so the customer must go elsewhere to meet this need. Finally, banks generally do not transmit payments to utility companies nor do they serve as agents for electronic money transfer services, such as Western Union.

Although most attention has gone to the relatively high fees that many of the unbanked incur for basic payment services, this may not be the major problem associated with their status. In 1997, in collaboration with a group of anthropologists, I conducted a series of detailed discussions with lower-income individuals, many of whom were unbanked, in two communities, San Jose, California, and a small town in Mississippi (Caskey, 1997b). In discussing their financial affairs, the unbanked rarely complained about the expense or inconvenience of obtaining payment services. Rather, they complained mainly about the insecurity and stress associated with living from paycheck to paycheck. This was also true of the individuals with bank accounts but who consistently ran down their account balances to near-zero at the end of each pay period. In both cases, the interviewed individuals commonly spoke of feeling physically and emotionally drained from facing frequent personal financial crises and worrying about the ones to come.

Because so many of the unbanked live from paycheck to paycheck with no financial margin of safety, many have been forced by past personal financial crises to miss scheduled payment obligations, such as rental, debt service, or utility bill payments. In my 1997 survey of 900 lower-income families, for example, 42 percent of the families without deposit accounts reported that they had been two months late on some bills in the previous year (see table 4). Among lower-income families with deposit accounts, 28 percent reported being late paying some bills in the previous year. Similarly, 41 percent of the unbanked families reported that they had been contacted by a bill collection agency in past year. Among the lower-income families with deposit accounts, 25 percent reported that they had been contacted.

These data indicate that the unbanked are more likely to have impaired credit records than are households with bank accounts. But they also indicate that problems with credit histories and

[4] As indicated in the report by the Board of Governors of the Federal Reserve System (2000), in 1999 all banks imposed fees for writing a check with non-sufficient funds to cover it. In that year, the average fee was $17.71. Since banks generally also charge a fee to businesses that deposit such checks (the average fee in 1999 was $6.28), merchants will commonly impose a charge (commonly $10 to $15) on their customers who write checks that bounce.

debt service burdens are widespread among lower-income households generally, including those with bank accounts. As indicated in table 5, this impression is supported by data from the Survey of Consumer Finances.

Problems in their credit histories and debt-service burdens leave a large share of the unbanked, and a significant share of lower-income households generally, cut off from mainstream credit.[5] When these households need short-term loans to meet emergencies, they find informal sources of credit or turn to high-cost formal-sector lenders such as pawnshops, car title lenders, payday lenders, and small-loan companies. Interest rates from these lenders are generally over 100 percent APR and often as high as 300 percent (Caskey, 1997a).

III. A proposed outreach strategy

This section sets out a strategy for bringing the unbanked into the financial mainstream. As noted earlier, the strategy has five elements. In this section I present the details behind the five elements of the proposed strategy. Before doing so, however, I should emphasize that, while the overall proposal is new, it embeds several other initiatives with similar goals that are already underway. For example, it includes efforts to design accessible low-cost deposit accounts, to create institutional mechanisms that facilitate people's efforts to accumulate saving, and to increase financial literacy within lower-income communities.

A. Open specialized bank branches that provide CCO services

The first step in the proposed strategy is for banks open specialized branches that offer the full range of commercial check-cashing services as well as standard consumer banking services. To distinguish them from other bank branches, I call these specialized bank branches "outlets." These outlets should cash low-risk local paychecks and government checks without placing a hold on the checks even for individuals who lack deposits to cover the checks.[6] Since people without checking accounts who cash their paychecks will need a means to pay bills, these outlets should sell money orders and stamps and envelopes in which to mail the money orders and they should serve as an in-person payment point for utility bills, cable TV bills, etc. They should also offer a service for transferring funds by wire, especially when the outlets are located in areas with large numbers of recent immigrants. Finally, when the unbanked cash paychecks and pay bills, they frequently want to obtain convenience items and services such as photocopies, fax

[5] As indicated in table 4, among unbanked lower-income households, only 14 percent carry a major credit card. Among lower-income households with deposit accounts, 59 percent do. Data from the Survey of Consumer Finances are similar (Hogarth and O'Donnell, 1999).

[6] Banks entering the check-cashing business should employ the standard software and operating procedures marketed to check-cashing outlets. These have been carefully refined over many years to speed check-cashing and related transactions while minimizing fraud and the risk of cashing checks that bounce. Using standard software and operating procedures, most check-cashing transactions take less than a minute. CCOs that employ these procedures, and that cash mainly payroll checks and government checks, report that losses from cashing "bad" checks amount to well under 0.25 percent of the face value of the checks they cash. For example, ACE, a publicly-traded company with a large chain of check cashing stores, reports that 0.4% of the face value of the checks it cashes are returned for NSF. Its net losses, after collection efforts, from cashing bad checks have been about 0.1% of the face value of the checks it cashes.

transmissions, prepaid telephone calling cards, and, in some regions, transit tokens. The outlets should provide such supporting products and services.[7]

If the outlets are to be successful, banks must locate them at points likely to be convenient for large numbers of low- and moderate-income households. The outlets will need to maintain hours similar to those of check-cashing outlets, meaning that they should be open early evenings and on Saturdays. Banks should also post prominent signage indicating that the outlets offer check-cashing services. In many cases, giving the outlets a CCO-type name, such as "Cash Express Center of Bank X," will serve this purpose. It also distinguishes the outlets from a bank's regular branches that do not offer check-cashing services.[8]

Opening such outlets serves three purposes. First, by offering CCO services in a bank branch, the bank establishes direct contact with CCO customers. Over time, banks can develop relationships with unbanked individuals which they can use to encourage them to take steps to build savings and address problems in their credit records. Simply put, banks cannot help the unbanked if they do not get them in the door. Second, the establishment of the outlets recognizes that many CCO customers are likely to be slow to open deposit accounts. As noted earlier, many simply do not have month-to-month savings and see little advantage to a deposit account. Others do not want deposit accounts for fear that their savings might be seized by creditors or might make them ineligible for welfare. By offering check-cashing services, banks can provide high-quality, relatively low-cost, payment services to such individuals who remain outside of the deposit system. Third, banks with branches in lower-income areas often report that it is difficult to cover the costs of these branches with traditional services since deposit mobilization is low, transaction levels are high, and loan opportunities are limited (Caskey and Humphrey, 1999).[9] If these branches were able to find new sources of revenue, such as check-cashing fees, this could contribute toward making these branches profitable and encourage banks to open branches likely to attract large percentages of lower-income households.

Banks opening such outlets should be able to set fees for check-cashing services that are somewhat lower than those of commercial check-cashing outlets and yet sufficiently high to be profitable for the banks. This is true for two reasons. First, the bank outlets, which will offer traditional consumer banking services as well as check-cashing services, should benefit from economies of scope. Earnings from both services can cover many of the same fixed overhead expenses. Second, banks, unlike commercial check-cashing outlets, have direct access to check-clearing systems and a relatively low cost of financial capital. This will eliminate some of the costs that check-cashers incur from the need to clear checks through the banking system and obtain working capital. In setting their check-cashing fees, banks should keep in mind that the

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[7] A closely related approach would be for banks to form partnerships with existing check-cashing outlets and to offer basic consumer banking services at service stations in the outlets. The problem with this approach is that any success that the bank has in converting CCO customers to banking customers would be to the disadvantage of the CCO. In addition, either partner might find itself uncomfortable with some of the business practices of the other. There may be contractual solutions to these potential problems, but devising the solutions could be complicated.

[8] There is an obvious parallel to the "private" banking divisions that many banks have opened to meet the specialized financial needs of the wealthy.

[9] Julian Barnes (1999) provides a compelling account of a money-losing bank branch that opened in 1997 in a low-income community in Brooklyn, NY. As one would expect, the branch has had difficulty attracting substantial deposits or booking an adequate volume of loans.

strategy calls on them to develop long-term relationships with their check-cashing customers. This suggests that they should offer discounted rates for frequent check-cashing customers.

B. Offer "starter" bank accounts that have low minimum-balance requirements, cannot be overdrawn, and include access to low-cost money orders for making long-distance payments

In addition to offering traditional fee-based check-cashing services, these specialized outlets should provide the full range of consumer banking services offered at a bank's traditional branches. This recognizes that, even in very low-income communities, there will be significant numbers of people who desire traditional deposit and credit services and can qualify for them. To the extent that an outlet can attract such customers, it makes banking services more convenient for some community members and helps to cover the costs of operating the outlet. In addition, since the outlet is intended to help the unbanked become traditional bank customers, it is helpful to have the banking services offered in a location in which the unbanked individual is already comfortable.

In addition to their traditional deposit accounts, the outlets should offer a low-cost low minimum-balance savings account with some non-traditional features. Account holders should also be able to purchase at a bank's outlets as many as ten money orders per month for no more than $0.75 each. The outlets should also offer them stamped envelopes and convenient processing of utility bill payments. For qualifying households, the account should include ATM and debit-card access. If the bank is able to block someone's ability to overdraw the account, then the bank should be able to provide ATM access even to households with severely impaired credit histories. Finally, the account should accept electronic deposits of wage payments and government transfers.

The proposed features of this account differ from those of two prominent other accounts that have been advocated as mechanisms to help the unbanked join the banking system. A number of advocates for the unbanked have sought to enact laws, called "basic" or "lifeline" banking laws, that would require banks to offer a low-cost checking account with a low minimum-balance requirement. A small number of states have enacted such laws but not the federal government. Although bank trade associations fought against such proposed laws, especially at the federal level, they called on banks to offer voluntarily such accounts. A majority of banks claim that they do (Daniel Krieger, 2000). In a second initiative, beginning in 1999 the U.S. Department of Treasury asked banks to offer "Electronic Transaction Accounts," or ETAs for short. The government wants banks to offer these accounts to order to encourage the use of direct deposit by unbanked recipients of federal transfer payments. Currently, the government must mail paper checks to individuals who do not have deposit accounts. In designing the ETA account, the government had two concerns. First, it wanted to ensure that the account was inexpensive for account owners, even for individuals unable to maintain a month-to-month balance. This was to provide the unbanked an incentive to open an ETA account, making them eligible for direct deposit. Second, the government wanted the account to be at least moderately profitable for banks so that they would be willing offer the ETA account. To meet these two goals, the government offers to pay banks $12.60 for each ETA account they open. It permits the banks to charge account owners up to $3 a month. The government requires that the accounts accept electronic payments from the federal government, have no minimum balance requirement, and permit the account owner to make up to four withdraws per month from the account. The withdrawals can be from a proprietary ATM machine or through a teller. The accounts need not include the ability to draw checks on them nor the ability to initiate electronic payments.[10]

There are good reasons to think that basic checking accounts and ETA accounts are unlikely to bring many of the unbanked into the banking system. A checking account can be very costly for someone who lives from paycheck to paycheck. Individuals who consistently run down their account balances to zero, or near-zero, at the end of each pay period are likely to bounce checks frequently unless they are especially scrupulous account managers. As noted earlier, writing a check that bounces commonly results in fees of $25 to $35, so people who bounce a few checks every other month or so will quickly spend more for their bank accounts than they would for using a check-cashing outlet. In addition, because banks fear that people who bounce checks might not pay the fees that banks charge to cover the banks' costs of handling the checks, they generally do not permit people with histories of bouncing checks to open or maintain a checking account.

Low-cost non-checkable transaction accounts, such as the ETA account, have a different problem. These accounts do not include any means for account holders to make long-distance payments. Since most banks charge comparatively high fees for money orders, do not sell stamps and envelopes, and do not handle utility bill payments, account holders have to go elsewhere to obtain these services. Given this situation, it should not be surprising if the unbanked prefer to remain out of the banking system. They can go to a check-cashing outlet, or grocery store that provides CCO services, and take care of all of their payment needs promptly in that one location.

Unfortunately, there are no data indicating whether or not basic checking accounts have drawn significant numbers of the unbanked into the banking system (Doyle et al, 1999). Anecdotal information suggests that they have not. Complicating the analysis, however, several surveys of banks in states requiring basic checking accounts have found that banks do not publicize these accounts and frequently steer customers to more costly alternative accounts (Terry Pristin, 1999). Such behavior is not surprising since banks claim that the accounts are unprofitable. The ETA account is quite new, but early data indicate that very few ETA accounts have been opened.[11]

The account that I propose has two advantages over the basic checking account and the ETA account. For one, banks can offer it to people who have a history of bouncing checks and people who fear the expense associated with bounced checks will not be deterred from opening the account. In addition, unlike the ETA account, it provides account holders with a convenient low-cost means to make long-distance payments: inexpensive money orders with stamped envelopes. If they desire, banks can design the proposed account to qualify as an "Electronic Transfer Account" in order to receive the $12.60 that the Treasury Department pays for each ETA account that banks open.

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[10] Michael Stegman (1999) provides an excellent discussion of the economics and politics behind the development of ETA accounts and a more detailed description of their features.

[11] Edmond Sanders (2000) reports that fewer than 1,000 ETA accounts were open nationwide as of July 2000. In August 2000, data on a U.S. Treasury Department website (www.eta-find.gov) indicated that in several major metropolitan areas, only a handful of credit unions and community banks offered the accounts.

C. Offer accounts specifically designed to help people build savings

In addition to the savings account described above, the outlets should offer a "savings-building" account. Although there can be many variations in the details of savings-building accounts, research on consumers' savings behavior indicates that these accounts should have several key features. First, in opening such an account, an individual should pledge to make regular fixed-value contributions to the account over a specified time period, usually a year. The timing of these contributions should closely coincide with the individual's receipts of income. Second, the bank should permit the required periodic contributions to be small, perhaps as little as $20 a month. Third, if possible, contributions to the account should be automatic. The contributions, for example, could be linked to a member's direct deposit of her salary or a check-cashing customer might agree to deposit $10 each time he cashes his biweekly paychecks. Fourth, a savings-building account should be a separate from other accounts that the individual might own. This helps separate the funds psychologically from savings for short-term transaction purposes. Finally, there should be some financial penalty if the account owner closes the account early or if she fails to keep her commitment to make specified deposits at regular intervals. In imposing this penalty, such as loss of accumulated interest, the bank should probably show some flexibility. It might, for example, permit one or two missed deposits before the penalty takes effect.[12]

The psychological basis of these rules is obvious. People have a hard time saving on a discretionary basis, so they save most effectively when the act of savings is relatively unconscious and the savings are viewed as "locked away" (Thaler, 1992).

This proposed savings-building account is similar in several of its features to the "Individual Development Accounts," or IDAs for short, that some banks and credit unions have begun to offer in partnership with philanthropic foundations, community-based organizations, or government agencies (Sherraden, 1991). There, are however, two main differences. The IDA accounts offer matching funds to lower-income individuals who accumulate and maintain savings over a designated period of time. In addition, holders of IDA accounts, if they are to receive the matching funds, must use their IDA savings for an approved set of purposes, such as education or the down payment on a home.

When matching funds are available and administrative costs are not a problem, the outlets might consider offering IDA accounts in addition to the savings-building account advocated above. The IDA account should not, however, replace the savings-building account. For one, the savings-building account is administratively simpler and lower cost, making it more likely that banks will offer the account. A bank can offer it to anyone. It need not verify that an account holder has a sufficiently low income to qualify. It also does not require the bank to find a source to provide matching deposits. More importantly, IDAs are intended to help people build

[12] A bank in Arkansas created a product that helps people build savings and improve their credit history simultaneously (Bugea, 2000). Participants in the program obtain a $1,000 term loan from the bank requiring monthly payments of about $90. The funds from the loan must be invested in a one-year CD, which serves as the collateral for the loan. At the end of one year, a borrower who successfully makes all loan payments on time will have accumulated $1,000 in savings and will have a history of successfully handling at least one loan. Moreover, because the CD earns interest, the net interest cost of the loan is less than $10.

medium- or long-term savings for a particular set of approved purposes. People living from paycheck to paycheck would benefit from such savings, but they also need short-term savings to dip into to handle periodic fluctuations in income and expenditures. Such short-term savings are a form of self-insurance; a financial margin of safety or "buffer" intended to prevent periodic personal financial crises. The balance of such buffer savings would fluctuate as they are tapped and replenished, but ideally there should usually be a month-to-month carry-over. The savings-building account is intended to help people accumulate a balance that they can use primarily for this purpose. At the end of one year, for example, a client might accumulate $400 in the savings-building account. The client could transfer some or all of these funds into a low-cost savings account to use as a financial buffer. The client might continue to participate in the savings-building program to augment these buffer savings. Once the client accumulates sufficient buffer savings, he or she might use the savings-building account or an IDA to initiate savings for a down payment on a house, education, or other long-term wealth-building measures.

D. Offer deposit-secured emergency loans to individuals whose credit histories make them ineligible for traditional mainstream credit

Although the outlets can compete with commercial check-cashers, in most cases they will not be able to provide traditional loans to people currently borrowing in the alternative financial sector. These people generally have far higher risk profiles than would be prudent for depository institutions to underwrite. AFS firms can provide credit to this population group by adopting labor-intensive risk-control procedures, such as prompt and persistent in-person debt collection. The outlets could try to follow a similar path, but pawnbroking and collecting unsecured sub-subprime debts are specialized skills that bank outlet employees are unlikely to possess or develop quickly. More importantly, in many cases it is doubtful that a bank outlet would be providing a beneficial service if it were to make short-term high-cost loans to financially hard-pressed individuals. This could simply worsen the borrowers' financial distress and the costs of the resulting consequences.

In some cases, however, bank outlets should be able to use creative means to meet customers' legitimate credit needs. Banks with branches in lower-income communities frequently report that many of their customers with good credit records occasionally seek unsecured non-revolving loans of under $1,000. Commonly, banks do not offer such loans because the processing and monitoring costs are high relative to the size of the loan. But with credit-scoring and other cost-saving technologies, the outlets may be able to make fast-disbursing small-value loans with fees that are attractive to both the customers and the banks.

Customers with impaired credit histories will also have legitimate needs for credit. To help meet this need, the outlets should offer deposit-secured loans to customers unable to pass standard credit-risk assessments. An outlet could, for example, issue a deposit-secured credit card to a customer. Or it could make a loan against the balance that a member has accumulated in a savings-building account. When the customer repays the loan, his or her savings are still in place. Moreover, if outlets offer such loans, customers may be more likely to agree to lock away their savings in savings-building accounts.[13]

[13] As noted in Caskey and Humphrey (1999), Borinquen Federal Credit Union serves a very low-income population group in Philadelphia. In 1998, almost all of its loans were deposit-secured personal loans. Frequently, the credit

The outlets should also consider partnering with a philanthropic foundation or community-based organization to arrange collateral for high-risk emergency loans to individuals without savings. As noted earlier, many lower-income households without financial savings face periodic financial crises caused by unexpected expenses or interruptions in the their incomes. When such a disruption occurs, the family may not be able to pay its rent or fix a car needed to get to work. This can lead to compounding crises, such a losing its housing or the loss of a job. Sympathetic as a bank might be, it cannot prudently make unsecured loans to high-risk applicants in such situations. But working with a third party, such as a not-for-profit community-based organization (CBO), the bank can help. The CBO, for example, could raise funds from philanthropic foundations and place these funds on deposit at the bank. A family with a poor credit record needing an emergency loan could apply to the CBO. If the CBO approved the loan application, the bank could book the loan using the CBO's deposit as collateral. Using such a process, the bank outlet could help meet some families' legitimate needs for emergency loans. By working with the bank, the CBO could leverage the funds that it raises for such emergency loans and benefit from a bank's expertise and cost-effectiveness in administering loans.[14]

E. Seek community-based partners and offer financial literacy programs

As the previous example makes clear, in launching outlets to serve the unbanked, banks can benefit by forming partnerships with not-for-profit community-based organizations. Of course in doing so, banks must tread carefully. Just because an organization is not-for-profit or declares itself to be "community-based" does not mean that it will be a good partner. Some CBOs operate primarily to promote the personal political or economic ambitious of their directors, and some are well-meaning but incompetent or have severe shortages of human and financial resources. In most large urban areas, however, there are numerous well-managed CBOs dedicated to helping lower-income individuals and communities.[15]

A partnership with an appropriate CBO can bring a number of benefits to a bank opening outlets to serve the unbanked and to the CBO. Most importantly, if the CBO is well-respected and well-connected in the community, it can help overcome any distrust that the community might have of the bank's motives. This role is especially important if a bank's managers and board of directors are separated from the target community by racial or ethnic barriers. In many cases, the CBO can help the bank find qualified community residents to staff the outlet, further tying the outlet to the community. The CBO also benefits from the partnership because it enables it to bring sophisticated financial services to the targeted neighborhood in a short time period. Some CBOs have tried, as an alternative strategy, to start their own credit unions. Most of these credit unions, however, remain very small with limited management capacity and can offer only a very restricted range of consumer financial products.

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union will lend about 150 percent of the accumulated balance in a savings account. The credit union managers report that this product is popular with the members and has encouraged them to build savings.

[14] As reported in Caskey and Humphrey (1999), Cincinnati Central Credit Union (CCCU) operates such a loan program in partnership with a CBO, SmartMoney Community Services.

[15] Frequently, CBOs promote the development of good-quality housing that is affordable to families with low and moderate incomes. In other cases their activities go beyond housing or they focus other issues, such as the improvement of job skills for residents of a lower-income neighborhoods.

In addition to forming a partnership with a CBO to launch outlets to serve the unbanked, banks should use the outlets as bases to promote appropriate financial literacy initiatives.[16] Although there is little reliable research demonstrating the effectiveness of financial literacy programs, anecdotal information and some quasi-experimental studies suggest that financial management counseling can help individuals to accumulate savings.[17] Typically, the educational programs are one of two types. One is remedial, focusing on helping people reduce their debt service burdens and address outstanding problems in their credit records. The other type is oriented toward wealth-building activities, such identifying cost-savings in family budgets and accumulating savings for retirement, education, or the purchase of a home.

This is not to say that the outlets should conduct such financial counseling programs themselves. Not only are such programs costly to offer, but banks may not be the appropriate institutions to deliver the information. Community-based organizations are likely to be more effective. For one, well-run CBOs will understand the particular financial literacy needs of their communities and have staff who can communicate comfortably with members of their communities. In addition, as not-for profit organizations, CBOs can apply to philanthropic foundations and government agencies to fund their financial counseling programs.

IV. Why it is realistic to expect banks to implement the proposed outreach strategy

If banks are to implement this outreach strategy, it must offer them an acceptable financial rate of return on their investment. But since delivering financial services to lower-income communities counts towards banks' Community Reinvestment Act obligations, banks may not need to earn as high of a return on capital as they seek in other activities. Naturally, the higher the expected return from pursuing the outreach strategy, the more likely are banks to embrace it.

There are a number of measures that banks can take to ensure that they earn an adequate rate of return from their outlets. To keep their operating costs low, the outlets should have flexible staffing, for demand for check-cashing services is closely tied to the paydays of local businesses and arrival dates for government transfer payments. In addition, the outlets should be small, perhaps taking no more than 1,000 square feet, as do many check-cashing outlets. Banks might also investigate using "souped-up" ATMs to cash paychecks, dispense money orders, and initiate utility bill payments within the outlets. If the ATMs are successful, they could reduce staffing costs for the outlets. Several firms have begun to produce ATMs with such capabilities but there

[16] Some advocates for the poor, while not objecting to such education efforts per se, believe that financial literacy efforts implicitly blame the poor for being poor. They argue that personal financial mismanagement is a tertiary issue. The primary and secondary issues are low household incomes and a social system that condemns some people to such a status. I do not disagree. But the underlying assumption of this paper is that, absent the political will to tackle the most important issues related to poverty, progress on tertiary issues is better than no progress.

[17] There is a pressing need to conduct random assignment studies of the effectiveness of financial literacy programs. People counseling low-income households planning to buy homes commonly report that such programs can be highly effective. Two studies using quasi-experimental data also suggest that financial education can affect people's savings behavior (Bayer et al, 1996, and Bernheim et al, 1997). But, absent random assignment studies, one suspects that the organizations offering financial literacy programs select participants who are most likely to change their behavior anyway or that clients who apply for and complete the programs are self-motivated to change their behavior. If so, the anecdotal accounts of the impact of financial literacy efforts are likely to be misleadingly optimistic. In addition, in the case of quasi-experiment studies, one must always wonder if the studies failed to control for the effect of important omitted variables.

is not yet any evidence that check-cashing customers have begun to use them in significant numbers. Apparently, most businesses that are purchasing and placing such ATMs are attempting to use them to replace check-cashing outlets. If banks were to place such ATMs within branch outlets, they might be more widely accepted. Customers would know that they can turn to humans staffing the outlets for assistance, which might increase their willingness to try the technology. This is the "bricks and clicks" model found to be successful in some other financial services. Finally, some banks may be able to lower the costs of opening outlets by sharing these costs with CBOs that share their desire to bring financial services to lower-income communities. A CBO, for example, might be able to raise funds from philanthropic foundations to purchase and equip an office. It could then rent this space to the bank on favorable terms.

Well-located outlets should have strong revenues. Assuming that they attract a moderately high volume of check-cashing business and levy check-cashing fees in the neighborhood of 1.0 to 1.5 percent, the outlets should earn about $100,000 a year from check-cashing and other payment service fees. [18] In addition to this income, the outlets will earn income from their traditional banking services. If these two businesses can be combined in one outlet with substantial economies of scope (the same teller can serve check-cashing and banking customers from the same facility), the outlets should be at least moderately profitable.

Undoubtedly, one consideration that may make banks reluctant to implement the proposed strategy is the "image" issue. Many community activists perceive check-cashing outlets as entities that "rip off" the poor. They might denounce vociferously any bank that opens a check-cashing outlet, even if the outlet charges relatively low fees, offers traditional consumer banking services, and has products intended to help CCO customers make the transition into banking customers. Moreover, were a bank to locate its outlets only in areas likely to attract low- and moderate-income households, it might be accused of "discriminating against the poor." While I recognize this danger, I do not believe it should prevent the implementation of the strategy. A bank can likely prevent such problems by obtaining the backing of respected community-based organizations before implementing the strategy. These CBOs could then take it upon themselves to explain the rationale for the bank's strategy and to emphasize that they are partners with the bank in the undertaking. Such an approach would likely squelch any criticisms of the bank.

[18] The largest publicly-traded check-cashing firm is ACE, America's Cash Express. Its 1999 SEC filings indicate that the average capital cost of opening a store is $60,000. It takes about 3.5 years for a store to mature. In a mature store, annual store expenses, including depreciation but excluding corporate overhead, are about $110,000. Major expenses include salaries and benefits (about $44,000), store occupancy ($25,000), check returns and cash shorts ($12,000), armored and security ($7,000) and depreciation ($6,000). A mature store, that does not make payday loans, earns annual revenues of about $160,000. About 74% of this revenue comes from check-cashing fees, 8% from bill payment fees, 7.5% from money transfer fees, 5% from money order fees, 2% from new customer fees, and 3% from other sources. ACE's typical fee for cashing a check is about 2.3%. ACE cashes almost exclusively payroll and government checks. A typical ACE store cashes about 1,200 checks per month with an average face value of $320. It sells about 1,600 money orders per month with an average face value of $131.

V. A "real-world" example

Although no deposit institution has implemented all of the elements of the proposed strategy, one bank, Union Bank of California, has implemented many of them. This section briefly describes its operations and experiences through early 2000.[19]

In 1993,Union Bank of California which currently has about $33 billion in assets, created "Cash & Save" outlets to offer check-cashing services and banking services in the same location.[20] Since that time, the structure and operations of these outlets have changed and they will likely continue to change as Union Bank refines its initiative. In early 2000, Union Bank had twelve Cash & Save outlets, mostly located in Los Angeles and San Diego. It also licensed an additional three, which were operated as pure check-cashing outlets without traditional banking services by a community based organization. Cash & Save is a separate administrative unit within Union Bank.

The twelve bank-owned Cash & Save outlets have three different structures. The earliest Cash & Save outlets are located in traditional bank branches as special Cash & Save teller windows. Signage outside of these branches prominently advertises "check-cashing." Four Cash & Save outlets are located within large discount stores that cater to moderate-income shoppers. These have the highest volume of transactions. They display prominently the Cash & Save name and give little emphasis to the Union Bank name. One Cash & Save outlet is located in a flashy high-tech laundromat that includes a brand-name video-rental and a fast-food store.

The Cash & Save outlets are bright and clean. The stand-alone outlets have the appearance of bank mini-branches, but the staff work within unobtrusive "bandit barriers" and security glass separates them from the customers. The stand-alone outlets are open evening hours on weekdays and have weekend hours.

In addition to providing traditional banking services to Union Bank customers, the Cash & Save outlets provide the full range of commercial check-cashing outlet services. They cash government checks and paychecks for non-depositors. The outlets sell money orders (with stamped envelopes), originate domestic and international wire transfers of funds, handle the payment of utility bills, sell pre-paid phone cards, provide fax and photocopying services, and in some locations sell bus tokens and passes.

A first-time check-cashing customer pays $3 to register as a Cash & Save "member." At that time, the bank records a digital photo, signature, the name of the customer's employer, and the name of the bank on which the employer's checks are drawn. The customer receives a membership card with a bar code that the bank can use in future transactions to identify the customer. The check-cashing fee is 1.5 percent of the face value of paychecks and 1.0 percent

[19] In the summer of 2000, Union Bank announced that it would begin to offer some banking services at the check-cashing outlets of a well-established commercial CCO. The bank also took a 40 percent ownership stake in this CCO. It is too soon to know how well this strategy will work out, but some people have criticized Union Bank for partnering with a CCO that makes payday loans.

[20] I thank Yolanda Scott Brown of Union Bank of California for the description of the operations of the Cash & Save outlets.

for government benefit checks.[21] Money orders cost either $1 or $0.50, depending on the location of the Cash & Save outlet.

Cash & Save also offers its check-cashing customers a "Money Order Plan." Under this plan, a customer pays a $10 annual fee. This gives the customer the right to six "free" money orders a month as well as a one percent check-cashing fee on all checks for one year. The purpose of the money order plan is to provide customers with an incentive to become regular customers. The bank hopes to use the repeated interactions to build trust with its check-cashing customers. It can use this trust to encourage them gently to build savings and become deposit customers.

In its Cash & Save outlets, as in its regular bank branches, Union Bank offers low-cost low-minimum balance checking accounts, named "basic checking," and low-cost low-minimum balance savings accounts. In addition, the Cash & Save outlets offer three non-traditional deposit accounts. First, they offer a "Benefit Transfer Service" that is similar to an Electronic Transfer Account. This is a deposit account that receives electronic deposits of government benefit payments. It does not offer an ATM card; people must go to a Cash & Save outlet to withdraw cash. There is no account maintenance fee and deposits receive a regular passbook savings interest. All withdrawals of cash from the account, however, are charged a one percent withdrawal fee.

The Cash & Save outlets also offer two plans to help check-cashing customers build savings. The first is the "Nest Egg" savings account. One can open this account with as little as a $10 deposit, but the account holder must also commit to deposit at least $25 a month for one year. The account does not include access to an ATM card and it is not intended as a transaction account. Anyone can open this account, even people with a history of writing bad checks or with severely impaired credit records. Account holders pay no fees for the account and they receive a passbook interest rate on their savings. They cannot withdraw funds from the account until the end of the year but the bank, at its discretion, does allow some emergency withdrawals. An account holder can close the account at any time. The second savings-building account is the "Combo" account. This is the Nest Egg account combined with the Money Order Plan. To open a Combo account one must deposit at least $10 in a Nest Egg account and commit to deposit at least $25 a month into the account for one year. As a Combo account holder, one pays a 1.0 percent check-cashing fee and receives six free money orders a month.

The Cash & Save outlets offer the standard consumer loan products but Union Bank managers report that the outlets originate relatively few loans. The managers believe that this is because many Cash & Save customers cannot pass traditional credit-risk screening standards or they want small short-term loans that the bank does not offer. The Cash & Save outlets have formed partnerships with local community-based organizations to offer personal financial management seminars on a quarterly basis. The CBOs host the seminars. The Cash & Save outlets publicize them.

Union Bank evaluates the success of the Cash & Save outlets by two criteria. First, the point of opening the outlets was to test the bank's ability to serve check-cashing customers and to help the

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[21] California law permits CCOs to charge 3% for individuals with proper identification cashing payroll or government checks. If the individual lacks the specified identification, the CCO can charge 3.5%.

customers become regular banking customers. By this criterion, Union Bank calls its Cash & Save outlets a success. The outlets, especially those located in the heavily trafficked discount stores, serve large numbers of check-cashing customers. Moreover, the bank reports that about forty percent of its regular check-cashing customers will use at least one traditional bank product (deposit account, credit card, etc) within a few years. Unfortunately, the bank does not report more detailed information about its ability to help check-cashing customers make the transition into regular bank customers.

The second criterion that Union Bank uses to judge the success of the outlets is their profitability. Bank managers report that are profitable, but they have not provided detailed financial information on their operations. They do relate, however, that the most successful are the stand-alone outlets located within the discount stores. These have very high volumes of check-cashing business, cashing almost three times the number of checks as do the in-branch Cash & Save locations. However, the stand-alone outlets have mobilized only very modest levels of deposits; customers have opened relatively few deposit accounts at these outlets and the accounts tend to have very small balances. The stand-alone outlets would not be profitable were it not for the check-cashing revenue. In fact, almost ninety percent of the revenue generated by the stand-alone outlets comes from check-cashing fees.

VI. The role for public policy and philanthropic foundations

The strategy outlined above for bringing more lower-income households into the banking system requires the participation of depository institutions. This does not diminish the supporting roles that should be played by other groups. As noted above, in many cases banks are likely to find their outreach efforts to be more effective, and less costly, if they can conduct them in partnership with community-based organizations. In addition, government agencies and philanthropic foundations can help promote the strategy and evaluate its effectiveness.

In proposing this strategy I am not calling for its immediate widespread implementation. Rather, my hope is that a small number of well-managed banks operating in diverse environments might implement it for three to four years in order to assess its cost-effectiveness. Success should be measured by the ability of participating banks to offer low-cost payment services to the unbanked, by the banks' ability to help the unbanked build financial savings and improve their creditworthiness, and by their ability to earn an acceptable rate of return from these efforts. Reports based on the Cash & Save initiative by Union Bank of California suggest that the strategy may be able to accomplish all of these goals to reasonable degrees, but these reports are not based on careful empirical assessments. Far more information is needed to determine the cost-effectiveness of the proposed outreach strategy.

One role that philanthropic foundations and government agencies can play is to help fund outreach efforts of the type suggested in this paper and to fund high-quality studies of the cost-effectiveness of these efforts. Without such support, few banks will be likely to incur the start-up costs associated with pioneering the strategy and even fewer will collect, analyze, and release detailed information of the successes and shortcomings of their initiatives. A second role that government can play is to clear any regulatory barriers that would prevent banks from implementing such pilot programs. Finally, if the strategy proves to be cost-effective, bank regulatory agencies could promote its implementation by giving greater weight in CRA compliance assessments to bank's efforts to provide basic financial services to lower-income households (the "service" test of the CRA compliance examination).[22]

VII. Conclusion

This paper proposes a new strategy for bringing the unbanked into the banking system. The strategy has five elements:

- Participating banks should open special branch offices, called "outlets," that are conveniently located for lower-income households and that provide fee-based check-cashing services along with traditional consumer banking services.
- These outlets should offer "starter" bank accounts that have low minimum-balance requirements, cannot be overdrawn, and include access to low-cost money orders for making long-distance payments.
- The outlets should offer accounts designed to help people accumulate savings.
- The outlets should offer deposit-secured loans to individuals whose credit histories would make them ineligible for mainstream credit.
- Participating banks should seek appropriate community-based organizations to help promote the outlets and to offer budget-management and credit-repair seminars to interested patrons of the outlets.

Even if this strategy were widely implemented, it will not reach all of the unbanked. Nor will it succeed in helping all of the ones that it does reach to build savings, improve credit histories, and lower the cost of their financial services. Nevertheless, with almost ten million unbanked households in the U.S., even a modest rate of success could mean significant improvements in the quality of life for hundreds of thousands lower-income families.

[22] Michael Stegman (1999) provides an excellent brief description of the weighting scheme under the current CRA assessment standards.

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Table 1

Percentage Families without Deposit Accounts

1998 Survey of Consumer Finances

Family characteristic	**Percentage without deposit account**
All families	9.5
Income (1998 dollars)	
Less than 10,000	38.1
10,000-24,999	13.5
25,000-49,999	4.2
50,000-99,999	0.7
100,000 and more	0.0
Age of head (years)	
Less than 35	15.4
35-44	9.5
45-54	6.5
55-64	6.1
65-74	5.9
75 or more	10.3
Race or ethnicity of respondent	
Nonwhite or Hispanic	24.2
White non-Hispanic	5.3
Current work status of head	
Working for someone else	7.3
Self-employed	4.6
Retired	12.8
Other, not working	30.9
Housing status	
Owner	3.8
Renter or other	20.8

Source: Kennickell et al

Table 2

Reasons Given in Caskey Survey for Why Households Do Not Have Deposit Accounts

Reason/reasons given	Percentage giving this reason
Don't need account because I have no savings	53.3
Bank account fees are too high	23.1
Banks require too much money just to open an account	22.1
I want to keep my financial records private	21.6
Not comfortable dealing with banks	17.6
Banks won't let us open an account	9.5
No bank has convenient hours of location	8.5

Problem fee/fees among those citing bank fees a barrier	Percentage giving this reason
Monthly account maintenance fee	28.4
Bounced-check fees	18.5
Check-writing fees	12.9
ATM fees	11.0

Source: Caskey (1997a)

Table 3

Primary Reasons in 1998 Survey of Consumer Finances for Why Households Do Not Have Checking Accounts

Reason	**Percentage Giving this Reason**
Do not write enough checks to make it worthwhile	28.4
Do not like dealing with banks	18.5
Do not have enough money	12.9
Service Charges are too high	11.0
Minimum balance is too high	8.6
Cannot manage or balance a checking account	7.2
Do not need/want an account	6.3
Credit problems	2.7
No bank has convenient hours or location	1.2
Other	3.1

Source: 1998 Survey of Consumer Finances (Kennickell et al)

Table 4

Indicators of Impaired Credit Records among Households with Incomes of $25,000 or Less

Indicator	**% families without deposit accounts answering "yes"**	**% families with deposit accounts answering "yes**	**Difference is statistically significant?**
Been more than 2 months late on some bills in the past year?	41.9	28.2	yes
Contacted by a bill collection agency in past year?	40.9	24.8	yes
Have a Visa, MasterCard, Discover or Optima credit card?	13.6	58.7	yes

Source: Survey conducted as part of Caskey (1997)

Table 5

Indicators of Debt Burdens and Debt Payment Difficulties

Family characteristic	**% with ratio of debt payments to family income above 40 percent**	**% with a debt payment late 60 days or more in previous year**
All families	12.7	8.1
Income (1998 dollars)		
Less than 10,000	32.0	15.1
10,000 - 24,999	19.9	12.3
25,000 - 49,999	13.8	9.2
50,000 – 99,999	5.7	4.5
100,000 or more	2.1	1.5

Source: 1998 Survey of Consumer Finances (Kennickell et al)